BANCO CENTRAL DO BRASIL

Minutes of the 177th Meeting of the Monetary Policy Committee (Copom)

Summary

Date: August 27th, 2013, from 4:20PM to 7:50PM, and August 28th, from 4:54PM to 7:31PM

Place: BCB Headquarters meeting rooms – 8th floor on August 27th and 20th floor on August 28th – Brasília – DF

In attendance:
Members of the Committee
Alexandre Antonio Tombini – Governor
Aldo Luiz Mendes
Altamir Lopes
Anthero de Moraes Meirelles
Carlos Hamilton Vasconcelos Araújo
Luiz Awazu Pereira da Silva
Luiz Edson Feltrim
Sidnei Corrêa Marques

Department Heads (present on August 27th)
Bruno Walter Coelho Saraiva - International Affairs Department
Daso Maranhão Coimbra - Department of Banking Operations and Payments System
Eduardo José Araújo Lima - Research Department (also present on August 28th)
João Henrique de Paula Freitas Simão - Open Market Operations Department
Márcio Barreira de Ayrosa Moreira - Department of Foreign Reserves
Renato Jansson Rosek – Investor Relations and Special Studies Department
Tulio José Lenti Maciel – Economic Department

Other participants (present on August 27th)
Edilson Rodrigues de Sousa – Coordinator in the Economic Department
Gustavo Paul Kurrle – Press Officer
Otávio Ribeiro Damaso – Chief of Governor ‘s Staff

The members of the Copom analyzed the recent performance of and the prospects for the Brazilian economy and for the international economy, under the monetary policy framework, which is designed to comply with the inflation targets established by the government.

Recent Economic Developments

1. Monthly inflation measured by the Extended Consumer Price Index (IPCA) changed 0.03% in July, after increasing by 0.26% in June. As a consequence, inflation in twelve months reached 6.27% in July (5.20% until July 2012). Market prices changed 7.86% in twelve months (5.77% until July 2012), and regulated prices recording the record low (1.31%) of the historical series started in 1994, down from 3.67% until July 2012. Among market prices, the prices of tradable goods increased 6.81% (3.08% until July 2012), and the prices of

non-tradable goods, 8.80% (8.24% until July 2012). The prices of food and beverages group registered 0.33% deflation in July, but changed 11.41% in twelve months (8.68% until July 2012). On its turn, the prices of services rose 8.48% in twelve months (7.90% until June 2012). In short, regulated inflation retreats, at the same time that non-tradables inflation remains at high levels, and the tradables inflation continues to increase.

2. The average of the underlying inflation measures, calculated by the BCB, changed from 0.39% in June to 0.28% in July. As a consequence, on a twelve-month trailing basis, inflation reached 6.26% (1.02 p.p. above the one registered until July 2012). Specifically, the smoothed trimmed means IPCA core inflation changed from 0.36% in June to 0.29% in July. The double weight core inflation, from 0.43% to 0.34%; the core inflation by exclusion of regulated prices and household food, from 0.38% to 0.35%; the non-smoothed trimmed means core inflation, from 0.31% to 0.21%; and the core by exclusion, which excludes ten household food items and fuels, from 0.46% to 0.20%. The diffusion index has declined since January (75.1%) and reached 55.1% in July.

3. Inflation measured by the General Price Index (IGP-DI) increased 0.14% in July (0.76% in June) and accumulated change of 4.84% in the twelve months through July (7.31% in the twelve months through July 2012). The main component of this indicator, the Wholesale Price Index (IPA), changed 4.02%, (against 7.93% until July 2012). According to the breakdown by stage of production, there were increases in the prices of raw materials (0.19%), intermediate goods (5.38%) and final goods (5.99%), according to the same comparison basis. Inflation measured by the Consumer Price Index (IPC), the second most important component of the IGP-DI, changed 5.80% in twelve months through July (5.65% in the twelve months through July 2012). The Civil Construction National Index (INCC), component with the lowest weight in the IGP-DI, changed 7.80% (7.27% in the twelve months through July 2012), partially driven by the labor cost, which increased 10.04% in the period. On its turn, the Producer/Manufacturing Industry Price Index (IPP/IT), calculated by the Brazilian Institute of Geography and Statistics (IBGE), increased 1.33% in June, expanding by 4.25% in twelve months. The Copom considers that the effects of the behavior of wholesale prices on consumer inflation will depend on the current and prospective demand conditions and on the price setters' expectations regarding the future inflation path.

4. The Economic Activity Index of the BCB (IBC-Br) incorporates estimate for the monthly production of the three sectors of the economy, as well as for taxes on products, and constitutes important coincident indicator of economic activity. Considering seasonally adjusted data, the IBC-Br increased 1.1% in June, after contracting by 1.5% in May. Year-over-year, the IBC-Br grew 2.3% in May and 2.4% in June. In the first half of the year, the indicator grew 2.9% year-over-year. The Consumer Confidence Index (ICC), from the Getúlio Vargas Foundation (FGV), expanded in August, reversing previous losses, due to improvements in the perception of both the current situation and in the expectations. The Services Sector Confidence Index (ICS) increased in August, after retreating in the previous month. On the other hand, the industrial businessmen confidence, measured by the Industry Confidence Index (ICI), decreased in August, and showed stability in expectations. Regarding agriculture, the Agricultural Production Systematic Assessment (LSPA), carried out by the IBGE, indicates that grains production should grow by 16.1% in 2013, relative to the 2012 harvest.

5. Similarly to other monthly activity indicators, the one related to industry has shown volatility in recent months, which, in part, reflects ajustments in the number of working days due to floating holidays. In this context, industrial production increased 1.9% in June, after retreating 1.8% in May, according to the industrial production series seasonally adjusted by the IBGE. In June, the industrial production increased in 22 out of the 27 surveyed activity sectors, on a month-on-month basis. The monthly production was 3.1% above the one registered in June 2012, resulting in increase of 0.2% in the last twelve months. According to data released by the National Confederation of Industry (CNI), real revenue in the manufacturing industry increased 5.3% in the first half of the year, compared to the same period of the previous year, and the number of hours worked increased 0.1%.

6. Among the industry use categories, the production of capital goods increased 18.0% in June, year-over-year; the production of intermediate goods, 0.4%; of durable consumer goods, 4.5%; and of semidurable and non-durable consumer goods, 2.3%. Month-on-month, according to data seasonally adjusted by the IBGE, the production of capital goods in June increased 6.3%, of durable consumer goods, 3.6%, and the one related to

semi-durable and non-durable consumer goods, 2.9%. On the other hand, the production of intermediate goods remained stable, according to the same comparison basis. Regarding growth accumulated in the last twelve months through June, there were expansions in the production of durable consumer goods (3.7%) and in the production of capital goods (0.3%). However, the production of intermediate goods and the one related to semi-durable and non-durable consumer goods retreated 0.2% and 0.1%, respectively, according to this comparison basis.

7. The unemployment rate in the six metropolitan areas covered by the Monthly Employment Survey (PME), without seasonal adjustment, was estimated at 5.6% in July (5.4% in July 2012). According to the BCB seasonally adjusted series, the unemployment rate in July stood at 5.5%, close to the record low of the historical series (5.3%), started in March 2002. The occupation level reached 54.0% of the Working Age Population (WAP), in July. The reduction in the WAP growth rate during the last years has contributed to the maintenance of the unemployment rate at historically low levels. Still according to the PME, the average real income increased 1.5% in July, year-over-year, and real payroll increased 2.7%, also compared to July 2012. Data released by the Ministry of Labor and Employment (MTE) show that 41.5 thousand formal jobs were created in July (142.5 thousand in July 2012). In short, the set of available data indicates narrow idleness in the labor market, despite more evident signs of moderation at the margin.

8. According to the retail monthly survey (PMC), released by the IBGE, retail sales volume increased 1.7% in June, year-over-year. Broad retail sales volume decreased 2.0%, according to the same comparison basis, influenced by the lower sales of vehicles, motorcycles, parts and pieces. According to the month-on-month seasonally adjusted series, in June retail sales changed by 0.5%, and broad retail sales, by 1.0%. Therefore, the broad retail sales growth rate in the last twelve months reached 6.4%, with expansion in all ten sectors surveyed. The Trade Confidence Index (ICOM), measured by the FGV, increased in August. The Copom evaluates that the retail sales trajectory will continue to be influenced by governmental transfers, by the pace of real payroll growth and by the moderate credit expansion.

9. The installed capacity utilization rate (Nuci) in the manufacturing industry, calculated by the FGV, without seasonal adjustment, reached 84.6% in August (84.4% in August 2012). According to the seasonally adjusted series calculated by the FGV, the Nuci in August stood at 84.2%. Capacity utilization in the capital goods sector, according to the seasonally adjusted series, stood at 81.9%. In the sector of consumer goods, intermediate goods and construction inputs, the utilization capacity stood at 82.5%, 86.1% and 90.8%, respectively.

10. The twelve-month trailing trade balance result retreated to US$4.5 billion in July. This result stemmed from US$239.6 billion in exports and US$235.1 billion in imports, which diminished 5.6% and increased 2.2%, respectively, compared to the previous twelve months. On its turn, the current account deficit accumulated in twelve months reached US$77.7 billion in July, equivalent to 3.4% of the GDP, while the foreign direct investment totaled US$62.3 billion in the twelve months through July, equivalent to 2.7% of the GDP.

11. In the global economy, a scenario of low growth prospects in important advanced economies prevail, notably in the Euro Zone, and volatility indicators have responded to the prospects of monetary policy change in the US. High unemployment rates in Europe, coupled with the efforts of fiscal consolidation and political uncertainties, are translated into investment decline and low growth. The composite leading indicator, released by the Organization for Economic Cooperation and Development (OECD), referring to June, however, signals improvement at the margin in several advanced economies, with prospects of growth above the trend, in constrast to the observed in emerging economies. Regarding monetary policy, accommodative stances have prevailed in the advanced economies. In emerging economies, in general, monetary policy is expansionist. Inflation has remained at moderate levels in the US and in the Euro Zone, and in Japan, it is slightly above zero.

12. The price of the Brent oil barrel has increased since the previous Copom meeting, reaching levels close to US$116, due to higher geopolitical risks. It bears highlighting that the geopolitical complexity that involves the oil sector tends to heighten the volatile behavior of prices, which also reflects the low predictability of some global demand components and the dependency of supply growth on long term risky investment projects.

Since the last Copom meeting, the international prices of agricultural commodities have decreased 0.7%, and the ones relative to metals have increased 6.6%. On its turn, the Food Price Index, calculated by the Food and Agriculture Organization of the United Nations (FAO), changed -3.3% in the twelve months through July 2013.

Assessment of Inflation Trends

13. The identified shocks, and their impacts, were reassessed according to the new set of available information. The scenario considered in the simulations was based on the following assumptions:
a) the projected adjustment for gasoline price for the whole year of 2013 was maintained at 5%, unchanged relative to the value considered at the July Copom meeting;
b) the projected adjustment for household electricity price points to a decrease of nearly 16%, compared to the 15% reduction considered at the July Copom meeting. This estimate considers the direct impacts of the sector charges reductions announced, as well as readjustments and ordinary tariff revisions planned for this year;
c) for the whole year of 2013, bottled gas prices are projected to increase by 2.5% and the fixed telephone tariff is projected to decrease 1.0%, compared to stability and retreat of 2% considered at the July Copom meeting, respectively;
d) the projected adjustment, based on individual items, for the set of regulated prices inflation accumulated for the whole year of 2013, remained at 1.8%, the same value considered at the July Copom meeting; and
e) the projected cumulative adjustment for the set of regulated prices in 2014 was maintained at 4.5%, the same value considered at the July Copom meeting. This projection is based on endogenous determination models for regulated prices, which compute, among other factors, seasonal components, market prices inflation, and the inflation measured by the IGP (General Price Index).

14. The projection for the spreads over the Selic rate, based on the 360-day swap rates, on the baseline scenario, estimates 77 bps and 18 bps spreads for the fourth quarters of 2013 and 2014, respectively.

15. The structural primary surplus that derives from the primary surplus trajectories for 2013 is considered as the fiscal indicator, according to the parameters set out in the Budget Guidelines Law (LDO)/2013; and, for 2014, according to the parameters set out in the Budget Guidelines Law Project (PLDO)/2014.

16. Since the last Copom meeting, the median of the projections compiled by the Investor Relations and Special Studies Department (Gerin) for the 2013 IPCA slightly decreased from 5.81% to 5.80%. For 2014, the median of the inflation projections decreased from 5.90% to 5.84%.

17. The baseline scenario assumes the maintenance of the exchange rate at R$2.40/US$1.00 and the Selic rate at 8.50% p.a. during the forecast period. Under this scenario, the projection for the 2013 inflation remained stable relative to the value considered at the July Copom meeting, therefore, it remains above the 4.50% midpoint target established by the National Monetary Council (CMN). According to the market scenario, which incorporates the consensus exchange and Selic rates trajectories collected by Gerin with market analysts, in the period immediately prior to the Copom meeting, the 2013 IPCA inflation forecast increased relative to the value considered at the July meeting. As a consequence, it stands above the inflation target. For 2014, in the baseline scenario, the inflation forecast remained stable relative to the figure considered at the July Copom meeting and increased in the market scenario, standing both above the 4.5% target. For the second quarter of 2015, the inflation forecast stays above the target in both scenarios.

Monetary Policy Decision

18. The Copom evaluates that the monetary policy should contribute to the consolidation of a favorable longer-term macroeconomic environment. In this respect, the Copom reassures that, under the inflation targeting regime, it guides its decisions according to BCB projected inflation and based on the analysis of alternative scenarios for the evolution of the main variables that determine prices dynamics. The Committee also understands that low risks for the underlying inflation in the short run tend to reduce uncertainties regarding the future behavior of headline inflation, facilitate the assessment of scenarios by the monetary authority, as

well as help the process of coordination of economic agents' expectations, particularly prices setters'. Additionally, it is noteworthy that low risks for the underlying inflation in the short run tend to intensify the effects of monetary policy actions, enabling them to affect in a more long-lasting manner the dynamics of headline inflation in the future. Although the Copom recognizes that other macroeconomic policy actions may influence the prices trajectory, it reaffirms its view that it is particularly under the responsibility of the monetary policy to remain especially vigilant, to guarantee that pressures detected in shorter horizons do not spread to longer horizons.

19. The Copom considers that, since its last meeting, the risks to global financial stability remained high, particularly those derived from the ongoing deleveraging process in the main economic blocks. Despite identifying low probability of occurrence of extreme events in the international financial markets, the Committee considers that the external environment remains complex. The Committee evaluates that, in general, the prospects for moderate global activity this year have remained, with trend of intensification over the relevant horizon for the monetary policy. There are localized improvements in advanced economies, although the space to use monetary policy remains limited and the fiscal restraint scenario prevails in this and in the upcoming years. In important emerging economies, however, the activity pace has not matched the expectations, despite the resilience of domestic demand. However, the Committee also highlights evidences of accommodation of commodities prices in the international markets, as well as greater volatility and dollar appreciation trend in the US.

20. The Copom evaluates that the main scenario encompasses a more intense domestic activity pace in this and in the upcoming year. Recent information indicate resumption of investments and continuity of household consumption growth, the latter favored by public transfers and by the vigor in the labor market, which reflects in historically low unemployment rates and in wages growth. In general, domestic absorption has expanded at rates higher than GDP growth rates and tends to be benefited by the effects of fiscal policy actions, by the expansion of credit supply, both for individuals and corporates, and by the program of public services concession, among other factors. However, the Committee notes that the speed of materialization of these expected gains depends on the confidence strengthening of companies and households.

21. The Copom observes that the main inflation scenario considers the materialization of the assumed trajectories regarding fiscal variables. For the Committee, conditions are created so that, in the horizon relevant for monetary policy, the balance of the public sector shifts to the neutral zone. The Committee also notes that the generation of primary surpluses in line with the working hypotheses considered for inflation projections, in addition to contributing to reduce the mismatch between supply and demand growth rates, strengthens the reduction trend of the public debt-to-GDP ratio and the positive perception regarding the macroeconomic environment in the medium and long terms.

22. The Copom highlights that its main scenario also considers moderate credit expansion. Still regarding the credit market, the Committee considers opportune initiatives with the aim of moderating the concessions of subsidies through credit operations.

23. In the factors market, the Copom highlights the narrow idleness margin in the labor market and it considers that, under such circumstances, a significant risk stems from the possibility of concession of wages increases incompatible with productivity growth and their negative impacts over inflation. Despite the moderation signs, the Committee evaluates that the wages dynamics remains originating inflationary cost pressures.

24. The Committee considers that the exchange rate depreciation and volatility observed in the recent quarters enable a natural and expected correction in relative prices. For the Committee, these movements in the local currency market, to some extent, reflect prospects for the transition of international financial markets towards normality, among other dimensions, in terms of liquidity and interest rates. It is also important to highlight that, for the Committee, the aforementioned exchange rate depreciation is a source of inflationary pressure in shorter periods. However, the secondary effects stemming from it, and that would tend to materialize over longer periods, can and should be limited by appropriate monetary policy handling.

25. The Copom evaluates that the high consumer inflation level in the last twelve months contributes for inflation to show resistance. In this context, the formal and informal indexation mechanisms and the deterioration in the economic agents' perception regarding the inflation dynamics are also included. Considering the damage that the persistence of this process would cause to the decision-making process on consumption and investment, in the Committee's view, it is necessary that, with the due promptness, it is reverted.

26. In this context, the Copom understands that it is appropriate to continue the adjustment pace of the monetary conditions underway.

27. Therefore, continuing the basic interest rate adjustment, the Copom unanimously decided to increase the Selic rate to 9.00% p.a., without bias. The Committee evaluates that this decision will contribute to set inflation into decline and ensure that this trend persists in the upcoming year.

28. The following members of the Committee voted for this decision: Alexandre Antonio Tombini (Governor), Aldo Luiz Mendes, Altamir Lopes, Anthero de Moraes Meirelles, Carlos Hamilton Vasconcelos Araújo, Luiz Awazu Pereira da Silva, Luiz Edson Feltrim and Sidnei Corrêa Marques.

29. The Copom evaluates that the domestic demand tends to be relatively robust, especially household consumption, largely due to the effects of stimulus factors, such as income growth and moderate credit expansion. This scenario tends to prevail in this and in the upcoming semesters, when domestic demand will be impacted by the remaining effects of the policy actions recently implemented. These effects, the programs of public services concession, the permissions for the exploration of oil, among others, create good prospects for investments and industrial production. On the other hand, the Committee notes that the fragile international scenario still represents an aggregate demand restraining factor. These elements and the developments in the quasi fiscal framework and in the assets market are important parts of the context in which future monetary policy decisions will be taken, aiming to ensure the timely convergence of inflation to the targets path.

30. The Copom emphasizes that the international evidence, in which it is ratified by the Brazilian experience, indicates that high inflation rates generate distortions that lead to higher risks and depress investments. These distortions are manifested, for example, in the shortening of the planning horizons of households, businesses and governments, as well as in the deterioration of the businessmen confidence. The Committee also emphasizes that high inflation rates subtract the purchasing power of wages and transfers, with negative repercussions over household's confidence and consumption. Therefore, high inflation rates reduce the growth potential of the economy, as well as of jobs and income generation.

31. The Copom highlights that, in moments such as the current one, the monetary policy should remain especially vigilant, in order to minimize risks that high inflation rates, such as the ones observed in the last twelve months, persist in the relevant horizon for the monetary policy.

32. At the end of the meeting, it was announced that the Committee will reconvene on October 8th, 2013, for the technical presentations, and on the following day, to discuss monetary policy, as established in the Communiqué 22,665, of June 27th, 2012.

SUMMARY OF DATA ANALYZED BY THE COPOM

Inflation

33. The IPCA-15 changed 0.16% in August, compared to 0.07% in July, according to the IBGE. The monthly acceleration reflected the increase of 0.11 p.p., to 0.22%, in market prices and the smallest decrease, from -0.07% to -0.04%, in regulated prices. The evolution in market prices reflected the acceleration in the prices of tradable goods, from -0.02% to 0.29%, and the deceleration in non-tradable goods prices, from 0.23% to 0.16%, comprising the deceleration in the prices of services, from 0.69% to 0.61%. The IPCA monthly acceleration was mainly favored by the lower deflation of the group transport, from -0.55% to -0.30%, with a contribution of -0.06% to the index, compared to -0.10% in July, and by the acceleration from 0.20% to 0.45%,

in the price of the group health and personal care, with contributions of 0.05 p.p. and 0.02 p.p., respectively. The diffusion index reached 60.55% in August, compared to 55.89% in July.

34. Considering periods of twelve months, the IPCA-15 increased 6.15% in August, compared to 6.40% in July. Market prices decelerated from 7.97% to 7.72%, reflecting the acceleration, from 6.63% to 6.70%, in the prices of tradable goods and the deceleration, from 9.19% to 8.64%, in non-tradable goods ones. Regulated prices change reached 1.26%, compared to 1.50% in the twelve-month period ended in July. Services prices increased 8.57%, the same change observed until July, compared to 8.65% in the twelve-month period ended in June.

35. The IGP-10 changed 0.15% in August, after increasing 0.43% in July, according to the FGV, a result of the deceleration in the IPA-10 and in the INCC-10, and the deceleration in the IPC-10. The IGP-10 increased 2.25% in the year, compared to 5.49% in the same period of 2012, and 4.12% in twelve months through August, compared to 5.62% in twelve months through July.

36. The IPA-10 changed 0.19% in August, compared to 0.49% in July, accumulating 1.17% in the year and 3.09% in twelve months. The prices of industrial products increased 0.43% in the month, compared to 0.38% in July, accumulating increases of 3.63% in the year and 4.55% in twelve months. The prices of agricultural products changed -0.45% in August and 0.80% in the previous month, accumulating changes of -4.84% in the year and -0.57% in twelve months. The monthly performance of industrial products prices evidenced, mainly, the increase in the prices of chemicals (1.42%); meat, meat products and fish (2.29%); and dairy products (4.61%), which contributed 0.11 p.p., 0.08 p.p. and 0.07 p.p., respectively. Regarding agricultural products prices, it bears noticing the changes in the items corn (-7.50%) and soybeans (-2.30%), contributing -0.14 p.p. and -0.12 p.p., respectively.

37. The IPC-10 changed -0.07% in August, compared to 0.13% in July, increasing by 3.56% in the year, compared to 3.64% in the same period of the previous year, and 5.65% in twelve months. The monthly deceleration of the IPC-10 in August reflected the decreases in the prices of some groups, such as transports, to -0.49% from -0.06% in July; food, to -0.30% from -0.37%; and apparel, to -0.93% from 0.03%, with contributions of -0.08 p.p., -0.07 p.p. and -0.05 p.p., respectively. The INCC-DI changed 0.35% in August, compared to 0.71% in July, with deceleration both in the prices of materials, equipment and services, from 0.47% to 0.39%, and in the costs of labor force, from 0.94% to 0.32%. The INCC increased 6.51% in the year and 7.56% in twelve months.

38. The IPP/IT increased 1.33% in June, compared to 0.24% in May, accumulating 1.56% in the year, compared to 4.51% in the same period of 2012. The monthly result of the IPP/IT reflected, mainly, the respective increases of 2.35% and 1.98% in the prices of food and other chemical products, contributing respectively 0.45 p.p. and 0.22 p.p. to the index. In twelve months, the IPP/IT changed 4.25% in June, compared to 4.03% in May, with highlights to the contributions of food, 0.81 p.p.; coke, oil byproducts and biofuels, 0.58 p.p.; and other chemical products, 0.55 p.p.

39. The Commodities Index Brazil (IC-Br) increased 2.27% in July, after increasing 5.34% in June, with valuations of 1.70%, 2.79% and 4.38% in the segments of agriculture, energy and metals commodities, respectively. The IC-Br accumulated a decrease of 0.22% in the year through July, a result of the devaluations of 4.81% and 0.36% in the segments of metals and agriculture commodities, respectively, and of the valuation of 5.24% in the segment of energy commodities.

Economic Activity

40. The IBC-Br increased 1.13% in June, month-on-month, considering seasonally adjusted data. The index changed 0.89% in the second quarter, quarter-over-quarter, when it had increased 1.10%, according to the same comparison basis. Considering observed data, the IBC-Br changed 2.35% year-over-year, compared to 2.28% in May, according to the same comparison basis, and accumulated increases of 2.90% in the year and of 1.94% in the twelve-month period through June.

41. Broad retail sales, which include vehicle and construction inputs, increased 1% in June, month-on-month, according to data seasonally adjusted from the IBGE’s retail monthly survey (PMC), after changes of -1.2% in May and 1.9% in April. Sales increased 1.4% in the second quarter, quarter-over-quarter, when they had recorded stability according to the same comparison basis. By segment, six out of the ten surveyed segments increased, with highlights for furniture and electronics, 1.8%. In contrast, it is worth mentioning the downturn in sales of textiles, apparel and footwear (-1.4%). Retail sales increased 0.5% in June, month-on-month, after stability in May and an increase of 0.6% in April, accumulating an average expansion of 0.5% in the second quarter, compared to the previous quarter. The retail sales increased 5.5% in the twelve-month period through June.

42. Considering observed data, broad retail sales decreased 2% in June, year-on-year, with emphasis in the retreat of 9.3% in the sales of the segments vehicles, motorcycles, parts and pieces Broad retail sales increased 6.4% in the twelve-month period ended in June, with highlights for the increase of other articles of domestic and personal use, 10.3%; pharmaceutical, medical, orthopedic, perfumery and cosmetic articles, 9.1%; vehicles, motorcycles, parts and pieces, 7.8%; and fuels and lubricants, 7.5%.

43. Automobile sales by dealers, including cars, light commercial vehicles, trucks and buses, reached 342.3 thousand units in July, decreasing 8.2% month-on-month, according to the Automotive Vehicles Distribution National Federation (Fenabrave), seasonally adjusted by the BCB. These sales increased 0.6% in the quarter ended in July, compared to the one ended in April, when they had decreased 7%, according to the same comparison basis. Considering twelve-month periods, automobile vehicles increased 4.1% in July, due to the increases of 4.6% in the sales of automobiles and of 4.1% in the ones related to light commercial vehicles. In contrast, the sales of trucks decreased 4.6%, whereas the sales of buses showed stability, according to the same comparison basis.

44. Capital goods imports quantum, released by the Foreign Trade Studies Centre Foundation (Funcex) and seasonally adjusted by the BCB, decreased 6.9% in July, month-on-month. The observed data analysis showed changes of 13.3% compared to July 2012, of 5.9% in the year, and of 2.3% in the twelve-month period ended in July.

45. Capital goods production increased 6.3% in June, accumulating an expansion of 3.9% in the second quarter, compared to the previous quarter, according to data seasonally adjusted from the Monthly Industrial Survey (PIM), by the IBGE. The monthly result reflected, especially, the increases in the production of non-serial industrial equipment, 6.8%; agricultural equipment, 3%; and transport equipment, 2.9%. In contrast, it bears highlighting the decrease of 5.1% in the segment of equipment for the electric energy sector. Considering the observed data, the expansion of 18%, year-over-year, reflected the increase in the production of agricultural pieces, 42.6%; transport equipment, 28%; goods for industrial series use, 26.2%; and agricultural equipment, 21.9%.

46. Construction inputs production increased by 0.6% in June, month-on-month, accumulating an expansion of 1.7% in the quarter, compared to the quarter ended in March, considering seasonally adjusted data. Considering the last twelve months through June, the segment production increased 1%.

47. Disbursements granted by the Brazilian Development Bank (BNDES) totaled R$190.8 billion in the twelve months through June, 39.5% above the same period of 2012. It bears emphasizing the growth of the resources destined to agriculture and the livestock sector (75%); commerce and services (61%), and industry (53%). In the period, the industry absorbed 32% of the total resources, followed by infrastructure (31%), commerce and services (28%) and agriculture and the livestock sector (9%).

48. Industrial production increased 1.9% in June, month-on-month, according to IBGE seasonally adjusted data, after decreasing by 1.8% in May, influenced by the expansions of 2.4% and 2.1% in mining and in the manufacturing industries, respectively. According to the use categories, there were increases in the production of capital goods (6.3%), followed by durable consumer goods (3.6%) and semi and non-durable consumer goods (2.9%), while the production of intermediate goods remained stable. Twenty-one out of the 26 manufacturing industry activities surveyed increased in the month, with highlights for the segments of office

machines and computer equipment (11.4%), pharmaceutical industry (8.8%), other transport equipment (8.3%) and footwear and leather (6.7%), in contrast to the decreases of 4.1% and 2% in the industries of petroleum refining and alcohol, and medical-hospital, optical instrumentation equipment, and others, respectively. The industrial production increased 1.1% in the quarter ended in June, quarter-over-quarter, when it had increased by 0.9%, reflecting changes of 0.8% both in the manufacturing and in the mining industries. It bears highlighting the increases in the industries of tobacco (41%); automotive vehicles (8.9%); and machinery and equipment (7.3%), and the retractions in the industries of electronic material and communication equipment (-4.6%); furniture (-3.9%); and beverages (-3.1%). Considering observed data, industrial production expanded by 3.1% in June, year-over-year, recording increase of 3.5% in the manufacturing industry, with highlights for the expansion of 18% in the capital goods production and for the retraction of 2.7% in the mining industry. The 4.3% expansion in the quarter ended in June, year-over-year, reflected, in particular, the increase of 17.9% in the capital goods industry, and the expansion of 0.2% in the twelve months through June was primarily driven by the increases in durable consumer goods (3.7%) and capital goods (0.3%).

49. The installed capacity utilization rate (Nuci) in the manufacturing industry reached 84.2% in August, 0.2 p.p. lower than the observed in July, according to data seasonally adjusted by the FGV. Among the use categories, there were decreases in the production of durable consumer goods (-0.9 p.p.), capital goods (-0.7 p.p.) and intermediate goods (-0.3 p.p.), while non-durable consumer goods and construction inputs increased 0.8 p.p. and 0.9 p.p., respectively. Considering the observed series, the Nuci increased 0.2 p.p., year-over-year, reaching 84.6%, as a result of the increases in the production of construction inputs (3.9 p.p.) and intermediate goods (0.9 p.p.), and of the decreases in the production of durable consumer goods (-3.9 p.p.), non-durable consumer goods (-2.6 p.p) and capital goods (-0.1 p.p.).

50. Vehicles output reached 312.3 thousand units in July, representing a decrease of 8.3% month-on-month, according to data released by the National Association of Automotive Vehicle Manufacturers (Anfavea), seasonally adjusted by the BCB. In the quarter ended in July, the production increased by 4%, quarter-over-quarter, when it had increased 1.7%. Considering observed data, vehicles output increased 3.7% year-over-year, 15.8% in the year and 12.7% in the twelve months through July.

51. Still according to data released by Anfavea, national vehicle licensing decreased 9.7% in July, month-on-month, and increased 2.1% in the quarter ended in July, considering data seasonally adjusted by the BCB. Regarding observed data, there were changes of -7.7% year-over-year, 5.5% in the year and 10.3% in twelve months. Automobile exports totaled 52.5 thousand units in July, representing increases of 75.9% year-over-year, 24.9% in the year and 0.2% in twelve months. According to the series seasonally adjusted by the BCB, exports increased 5.2% in the month, month-on-month, and 19.2% in the quarter ended in July, as compared to the quarter ended in April.

52. The LSPA survey carried out by the IBGE regarding July projected 187.9 million tons for the 2013 national harvest of grains, representing changes of 16.1% year-over-year and 1.2% over the June crop estimate. The increase in the prognosis for 2013, month-on-month evidences mainly the expected increases for the harvest of wheat, beans (2^{nd} crop) and corn (2^{nd} crop), 33.4%, 20% and 19.6%, respectively, compared to 26.9%, 13.7% and 14.8%, respectively, in June. Compared to 2012, the estimated expansion is due, in particular, to the expected growth of the production of soybeans (23.7%) and corn (12.2%). Moreover, a 10.3% increase over the previous year is estimated for the harvest of sugar cane, according to the same comparison basis.

53. The Monthly Service Survey (PMS), a monthly indicator of the sector carried out by the IBGE, began to be released this month. According to the PMS, the nominal revenue from the services sector increased 8.6% in June, year-over-year, compared to 7.6% in May and 11.6% in April. The result mainly reflected the increases of other services segments (11%), transportation, support activities for transportation and mailing activities (9.8%) and services rendered to families (9%). The nominal revenue of the services sector increased 8.4% in the year, with highlights for the segments of transportation, support activities for transportation and mailing activities (10.8%), services rendered to families (9.3%) and professional, administrative and complementary services (8.3%).

Surveys and Expectations

54. The Consumer Confidence Index (ICC), considering seasonally adjusted data from the nationwide Consumer Expectations Survey (FGV), reached 113.1 points in August. The increase of 4.4% month-on-month reflected changes of 7.3% in the Current Situation Index (ISA) and 3.5% in the Expectations Index (IE). According to observed data, the ICC decreased 6.3% year-over-year, due to decreases of 12.8% in the ISA and of 2.3% in the IE.

55. The ICS, carried out by the FGV, considering seasonally adjusted data, reached 116.5 points in August, The increase of 4.3% month-on-month reflected increases of 3.2% in the Current Situation Index (ISA) and 5.2% in the Expectations Index (IE). The ICS decreased 2.4%, year-over-year, due to the decreases of 5% in the ISA and of 0.5% in the IE.

56. The Commerce Confidence Index (ICOM), measured by the Commerce Survey, from the FGV, reached 126.1 points in August, decreasing 1% year-over-year. The result reflected the decreases of 2.2% in the Expectations Index (IE-COM), partially offset by the increase of 0.8% in the Current Situation Index (ISA-COM). In the quarter ended in August, the ICOM decreased 2.8%, year-over-year, due to the retractions of 3.5% in the ISA-COM and of 2.5% in the IE-COM.

57. The Manufacturing Confidence Index (ICI), considering data seasonally adjusted from the nationwide Manufacturing Survey (FGV), reached 99.0 points in August, a decrease of 0.6% month-on-month seasonally adjusted, driven by the decreases of 1.1% in the Current Situation Index (ISA) and 0.1% in the Expectations Index (IE). The ICI decreased 4.9% year-over-year, as a result of the decreases of 5.3% in the ISA and 4.5% in the IE.

58. The Construction Confidence Index (ICST), measured by the Construction Survey, from the FGV, reached 114.0 points in August, decreasing 5.3% year-over-year. The result reflected retreats of 8.6% in the Current Situation Index (ISA-ICST) and 2.5% in the Expectations Index (IE-ICST). In the quarter ended in August, the ICST decreased 4.7%, year-over-year, influenced by the decreases of 8.5% in the ISA-ICST and 1.4% in the IE-ICST.

Labor Market

59. According to the General Record of Employment and Unemployment (Caged) of the Ministry of Labor and Employment (MTE), 41.5 thousand formal jobs were created in July, down from 142.5 thousand in the same month of 2012, of which 18.1 thousand jobs in the agricultural sector, 11.2 thousand in the services sector and 7.2 thousand jobs in the manufacturing industry. In the year, 699 thousand jobs were created and, in the twelve months through July, 566.4 thousand, compared to 1.0 million and 1.2 million, respectively, in the same periods of 2012. Month-on-month, formal job creation expanded by 0.1% in July, considering data seasonally adjusted by the BCB.

60. According to the IBGE employment survey (PME), conducted in the six main metropolitan areas of the country, the unemployment rate reached 5.6% in July, representing retraction of 0.4 p.p. month-on-month and expansion of 0.2 p.p. year-over-year. The monthly result reflected increases of 0.7% in the employed population and of 0.3% in the Economically Active Population (PEA). Year-over-year, the employed population increased 1.5%, compared to 0.6% in June, according to the same comparison basis. Considering seasonally adjusted data, the unemployment rate decreased from 5.7% in June to 5.5% in July. According to the same survey, the average real income usually earned by workers decreased 0.9% month-on-month and increased 1.5% year-over-year. Real payroll, defined as the product of the number of persons employed by the usual real average income of the main work, changed -0.2% and 3%, respectively, according to the same comparison bases.

61. The total credit in the financial system, including the non-earmarked and earmarked credit operations, totaled R$2,546 billion in July, with expansions of 0.6% in the month and 16.1% in twelve months. The credit-to-GDP ratio reached 55.1%, compared to 55.2% in June and 51.1% in July 2012. The balance of non-earmarked

credit operations, equivalent to 56.7% of the total credit outstanding in the financial system, remained stable in the month and rose 9.2% in twelve months, reflecting respective changes of 1% and 8.2%, respectively, for credit operations with individuals and -1.1% and 10.1%, respectively, for credit operations with corporate. The earmarked credit operations increased, respectively, 1.3% and 26.6%, according to the same comparison bases, with highlights for the increases of 2.7% and 35.5%, respectively, in mortgages, for the segment of individuals, and 1.6% and 17.2%, respectively, in the BNDES's financing for the operations destined to corporate.

Credit and Delinquency Rates

62. The overall average interest rate of loans in the financial system reached 19.1% p.a. in July, representing expansion of 0.6 p.p. month-on-month and a fall of 0.8 p.p. year-over-year. The average rates for the segments of individuals and corporate reached, respectively, 25.1% and 14.4%, corresponding to expansions of 0.9 p.p. and 0.3 p.p., respectively, month-on-month, and retreats of 1.1 p.p. and 0.7 p.p., year-over-year.

63. The overall average tenure on credit operations reached 94 months in July, representing increases of 0.4 month, month-on-month, and 13.8 months, year-over-year. The average tenure related to individuals reached 133.9 months, increasing 1.2 month, month-on-month, and 19 months, year-over-year. In the corporate segment, the average tenure reached 63 months, decreasing 0.6 month, month-on-month, and increasing 9.3 months, year-over-year.

64. The delinquency rate in the financial system, corresponding to operations in arrears for more than ninety days, stood at 3.3% in July, decreasing 0.1 p.p., month-on-month, and 0.5 p.p., year-over-year. The indicators related to operations with individuals and corporate reached 5% and 2%, respectively, in July, with stability and a decrease of 0.1 p.p., in the same order, month-on-month, and reductions of 0.9 p.p. and 0.2 p.p., in twelve months.

External Environment

65. The global economic recovery remains at a moderate pace, highlighting the acceleration in the advanced economies. In the second quarter, the annualized quarterly GDP growth reached 1.7% in the US, 1.1% in the Euro Area, 2.9% in the UK and 2.6% in Japan, compared to variations of 1.1%, -1.1%, 1.1% and 3.8%, respectively, in the previous quarter. In the US, recent economic indicators remain positive, with the services PMI advancing to 56 in July, the highest level since February 2012, and the unemployment rate dropping to 7.4% in July, although still at a high level. In the Euro Area, the second quarter GDP recorded the first increase after six consecutive quarters of contraction, with highlight for the growth in Germany, 2.9%, and France, 1.9%, compared to stability and -0.6%, respectively, in the previous quarter. Recent economic indicators for the region, such as the economic sentiment index, the industrial production and the composite PMI, which rose in August to the highest level in 26 months, point to continued growth in the third quarter. In the UK, the composite PMI for July, calculated by Markit, reached 59.8, the highest level of the series started in 1998. In Japan, the private consumption was the main driver of growth in the first two quarters of the year, followed by net exports and government spending. Despite the slowdown in the GDP in the second quarter, according to preliminary data, the market outlook for growth in 2013 have remained at 1.9% since June, above forecasts of 0.7% in January and 1 4% in May. In China, the quarterly GDP annualized growth reached 7%, against 6.6% in the previous quarter. The manufacturing industry PMI in China rose to 50.1 in August, up from 47.7 in July, after three consecutive months of decline.

66. Financial markets operated under intense volatility, amid the uncertainties associated to the anticipation of the reduction of the monetary stimuli by the Federal Reserve (Fed). In this sense, there was an additional increase in annual yield of US Treasury ten-year bonds. In this environment, the US dollar appreciated against emerging economies' currencies, notably South Africa, Brazil, India, Indonesia and Turkey, while decreased relative to the euro, the pound and the yen. The indexes representative of the stock market rose in Germany, South Africa, Brazil, China and France, in contrast to the decreases in the stock markets of Japan, India, Turkey and Malaysia.

67. In the international commodities market, the prospects for good crops in 2013/2014 contributed to the decrease in the agricultural prices, except for soybeans, with significant increase in the most recent period, due to unfavorable weather outlook in the US. Metal commodity prices advanced significantly, highlighting the increases of tin and iron ore, the latter driven by the growth of imports of the metal by China. In the segment of energy, it is worth mentioning the rising of the barrel price of the Brent crude oil, due to geopolitical tensions in the Middle East.

68. According to the International Financial Statistics, from the International Monetary Fund (IMF), the annual change in the global CPI rose from 3.2% in May to 3.4% in June, result of the second consecutive increase in prices in the advanced economies, from 1.2% to 1.5%, partially offset by the fourth consecutive monthly decline in prices in emerging economies. The central banks of the US, Euro Area, Japan and UK maintained their respective official interest rates at historical minimum, while the monetary authorities of Australia, Hungary and Romania expanded again the expansionary stance of their policies, by reducing their respective basic rates. In contrast, the central bank of Indonesia increased its basic interest rate. The BoE introduced forward guidance in their institutional communication, communicating that it does neither intend to raise its discount rate (bank rate) from the current level of 0.5% nor reduce the size of the asset purchase program while the rate of unemployment is above 7%, since the projection for consumer price inflation on the horizon between 1.5-2 years does not exceed 2.5%, the medium-term inflationary expectations remain sufficiently well anchored and there are no significant risks to the financial stability. The ECB added to its communication that the current stance of monetary policy will remain accommodative for the time deemed necessary, confirming that the rates will remain at current levels or below, for a prolonged period.

Foreign Trade and International Reserves

69. The Brazilian trade balance showed a deficit of US$1.9 billion in July, as a result of US$20.8 billion in exports and US$22.7 billion in imports. The accumulated deficit in the year totaled US$5 billion, compared to a surplus of US$9.9 billion in the same period of 2012, reflecting a decrease of 1.5% in exports and an increase of 10% in imports, according to the daily averages. The total external trade stood at US$275.5 billion in the first seven months of the year, with expansion of 4.1%, compared to the same period of 2012, considering the daily average criterion.

70. The international reserves according to the liquidity concept, which includes repurchase lines, totaled US$373.7 billion in July, an increase of US$2.6 billion month-on-month and a decrease of US$4.9 billion in the year. According to the cash concept, the outstanding totaled US$372 billion, an increase of US$2.6 billion month-on-month and a decrease of US$1.2 billion compared to December 2012. There was no spot intervention in the year.

Money Market and Open Market Operations

71. After the July Copom meeting, the domestic yield curve showed increase in all its extension. On the foreign outlook, the expected reduction, in the short term, of the monetary stimuli by the Fed, continued to influence the markets' dynamics, maintaining the global trajectory of appreciation for the US dollar and the increase of the US Treasury bonds rates. In the domestic outlook, the possible impact of the depreciation of the BRL over price indices, the uncertainties related to the conduction of the federal government fiscal policy and the reduction of positions in the interest rate futures market (stop loss), contributed to the rise in interest rates. The increase in the yield curve was partially reversed at the end of the period, after the realization of repurchase auctions of fixed interest rates bonds by the Treasury and the announcement of a program of daily foreign exchange market interventions by the Central Bank. Between July 8th and August 26th, the one-, three- and six-month rates increased by 0.49 p.p., 0.57 p.p. and 0.69 p.p., respectively. Rates for maturities of one, two and three years increased by 0.84 p.p., 0.88 p.p. and 0.73 p.p., respectively. The real interest rate, measured by the ratio between the one-year nominal interest rate and the inflation expectation (smoothed) for the next twelve months, rose from 3.35% on July 8th to 3.72% in August 26th, mainly due to the increase in nominal interest rates.

72. From July 9th to August 26th, the the BCB carried out traditional FX swap auctions maturing in November and December 2013 and January, February and April 2014. These operations totaled the equivalent to the amount of US$27 billion, of which US$10 billion relative to the rollover of the contracts maturing on August 1st and September 2nd. On August 26th, the FX short net result of the BCB regarding this instrument totaled the equivalent to US$41.0 billion in notional value.

73. In the management of the liquidity of the banking reserves' market, the BCB conducted, from July 9th to August 26th, daily repurchase agreements with maturity of 3 months, taking funds of R$73.8 billion and, weekly, repurchase agreements with maturity of six months, taking funds of R$23.7 billion. The overall daily average outstanding of the long-term operations retreated from R$446.8 billion, between May 28th and July 8th, to R$294.8 billion, between July 9th and August 26th. In the same period, the BCB conducted repo with maturity of 35 working days, bringing overall daily average of the short-term borrowing operations to R$281.4 billion. The BCB also carried out overnight repo agreements on 35 occasions as a borrower. It also conducted leveling operations, at the end of the day, with tenure of two working days. The overall daily average of such overnight operations was R$130.5 billion in the period. The overall daily average of the total outstanding of repurchase agreements of the BCB increased from R$700.0 billion, between May 28th and July 8th, to R$706.7 billion, between July 9th and August 26th. Considering the period between July 8th and August 26th, the outstanding of repurchase agreements decreased from R$741.1 billion to R$659.2 billion. The main factors driving the liquidity contraction in the period were the net revenues of the Union and the net issuance of securities by the National Treasury.